Credit Rating Challenges for MSMEs

To,
J.B. Nagar CPE Study Circle of WIRC

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Topics of Discussion

- Difference among Credit Rating Agencies (CRA), Credit Bureaus (CB) and B2B Data
- Indian CRAs vs Global CRAs
- Regulations in India for CRAs
- About CareEdge
- Risk Assessment Framework
- Practical Challenges faced by MSMEs during the Credit Rating Process
- Policy on Default and Rating Performance
- Rating Performance
- Q & A

Difference among Credit Rating Agencies (CRA), Credit Bureaus (CB) and Dun and Bradstreet (D&B)

CRA vs CB vs B2B Data

Category	CRA	CB	B2B Data
Function	Evaluate corporate creditworthiness	Track borrower's credit information history	Business risk assessment
Key Output	Rating (AAA - D)	Credit report and Credit Score (300-900)	PAYDEX Score / D-U-N-S Number
Users	Investors, Lenders, Regulators	Banks, NBFCs etc	Mainly for B2B Businesses, Suppliers and Lenders
Examples	CARE, CRISIL, ICRA	CIBIL, Experian, Equifax, CRIF Highmark	D&B

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Indian CRAs vs Global CRAs

Indian CRA	Aspects	Global CRA
SEBI & RBI	Regulator	SEC (USA), ESMA (EU)
CARE CRISIL ICRA India Ratings and others	Examples	S&P Moody’s Fitch
Domestic Markets	Focus	Sovereign and International
INR based	Rating Scale	USD / Local Currency based

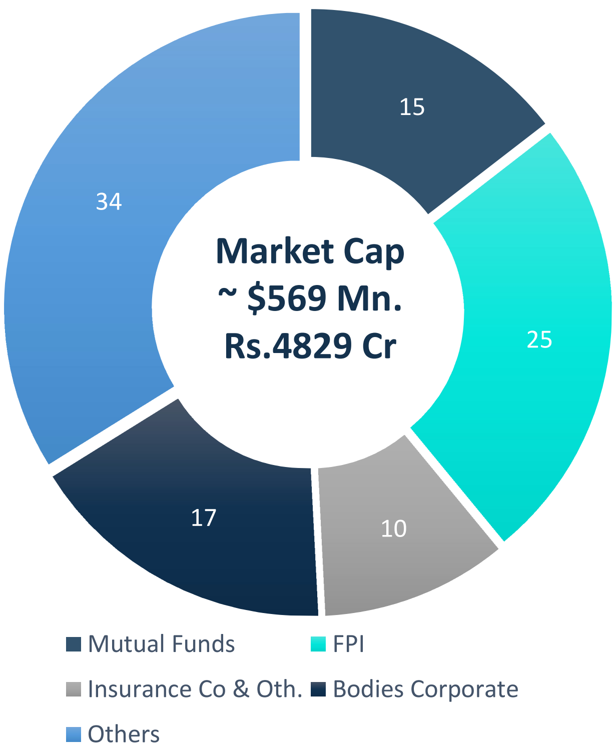
Regulations in India for CRAs

Regulator	• SEBI (Credit Rating Agencies) Regulations, 1999 • Reserve Bank of India
Key Rules	• Mandatory Registration • Transparent Methodology • Periodic Review • Disclosure of Conflicts of Interest • Code of Conduct Compliance • Press Release and Rating Report

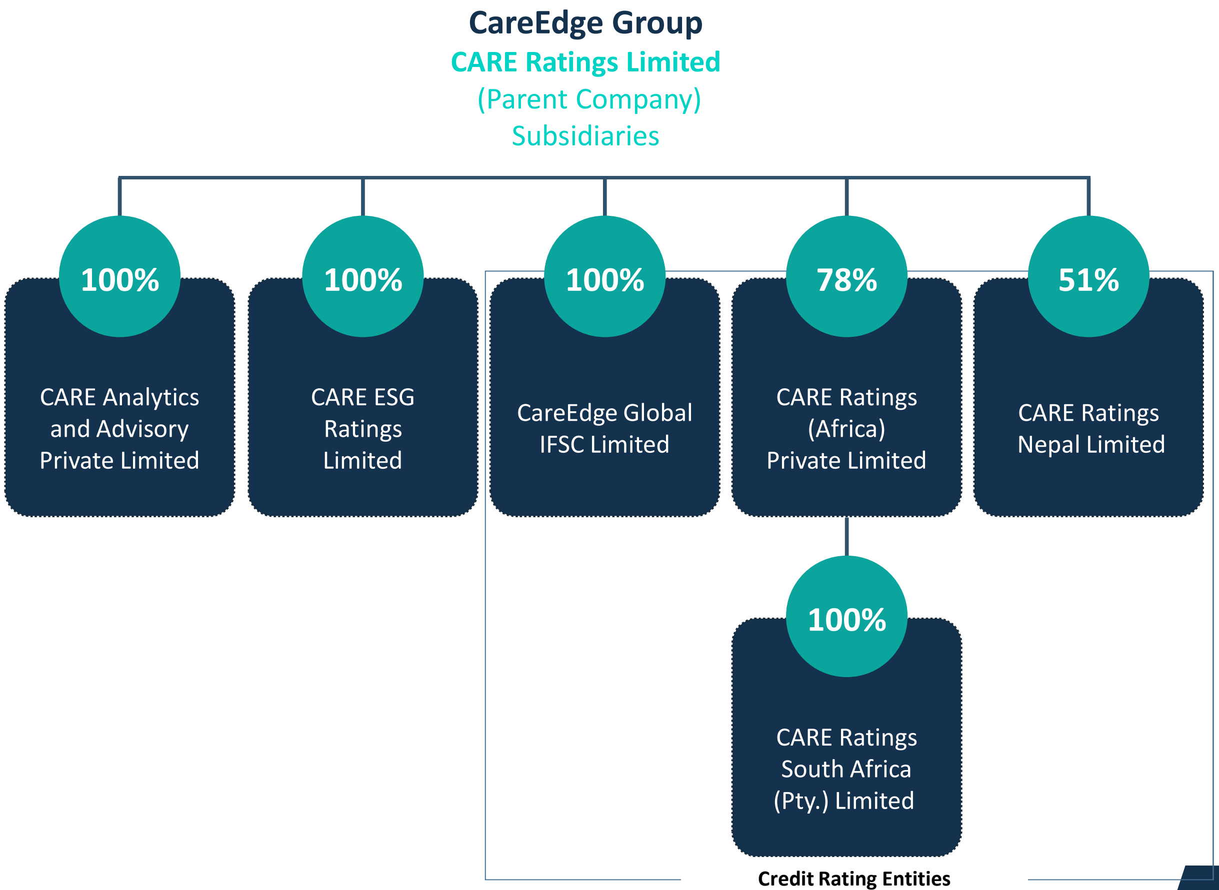
About CareEdge

About CareEdge

CARE shareholders (June 2025)

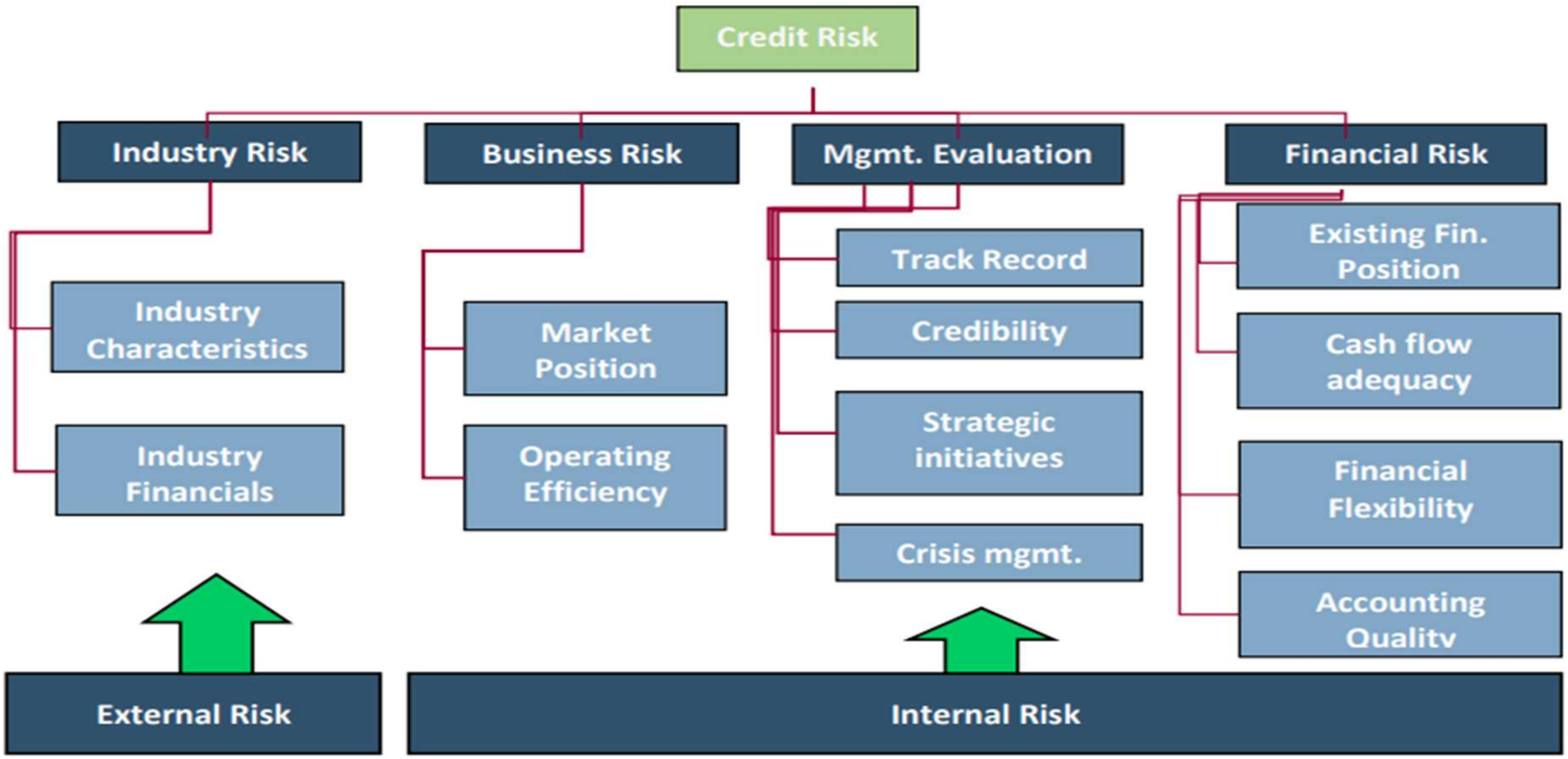


CareEdge Group



Risk Assessment Framework

Risk Assessment Framework



For companies with planned capital expenditure, project risk is also considered

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Risk Analysis

Economy and Industry Risk Analysis

Size of the Industry and Demand Supply Factors

Price Trends, Investment Plans of the major players in industry

Change in Technology, International/ Domestic Competitive Factors

Entry Barriers and Availability of Substitutes

Capital Intensity and Business Cycles

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Risk Analysis

Business Risk Analysis

Diversification

Seasonality and Cyclicality

Size, Market and Competition

Earnings Capacity

Cost Structure and Operating Efficiency

Risk Analysis

Financial Risk Analysis

Financial Ratios, Cash Flows and Liquidity

Accounting Quality and Contingent Liabilities

Financial Flexibility

Validation of Projections and Sensitivity Analysis

Working Capital Analysis and Foreign Exchange Risk Analysis

Risk Analysis

Management Evaluation

Track Record

Corporate Strategy

Legal Constitution, Ownership Pattern and Control Systems

Performance of Group Concerns

Organizational Structure, Personnel Policies and Corporate Governance

Risk Analysis

Project Risk

- Rationale for implementing project
- Size of the project vis-à-vis current scale of operations
- Networth, Funding Pattern, Cost over-runs, project cost vis-à-vis industry benchmarks
- Achievement of financial closure and status of regulatory approvals
- Equipment suppliers agreement, Track Record, Project completion against timeline

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Practical Challenges faced by MSMEs during the Credit Rating Process

Collateral based Lending Bias

Details of the Company

- Emerging Player in EPC
- Growing at a rapid pace
- Developed indigenous technology

Issues faced

- With growth increase in working capital requirement
- Being EPC player – LC/BG requirement was higher

Option Resorted

- Availed LC/BG facility with against FD which created cash flow issues
- Company availed NCDs with tenor of 2 years with majority of repayment falling due in 1-1.5 years

Suggestions

- Never bought assets in the company's books
- To build assets in the books which can help in giving it as collateral

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Quality of Audit Report

Details of the Company

- Growing player in Road Construction space
- Getting direct orders as well as on sub-contract basis
- Diversified customers across PSU and Private Players

Issues faced

- The company entered into JV with another player, floated and SPV wherein it had given Corporate Guarantee (CG) to the full value of the contract (~ Rs. 1,000 crore)
- CG becomes a reportable item under Contingent Liability and CARO report
- The auditor missed to report such CG given in CARO Report

Option Resorted

- During the Credit Rating Process, it was noticed by the Analytical Team and discussed in the Committee
- It was brought to the notice of the client and auditor
- Auditor conveyed that it was a missed in inadvertently

Suggestions

- We, at CareEdge, give utmost importance to the Audit report to gauge Governance
- It has quite a significant amount which was missed and subsequently it had bearing on the rating outcome

Hygiene Issues and Regulatory Burden

Details of the Company

- Growing player in Construction space in North India
- Exponential Growth was visible after more than two decades of vintage
- Diversifying into Solar Installation Business

Issues faced

- To cope with growth the company did not have adequate working capital facility which resulted in Overutilization, Cheque Bounces and Penal Charges
- The company was irregular in submitting stock statement and getting stock audit conducted
- The auditor reported lapses in compliances of PF and ESIC during Q2-Q4 of FY24

Option Resorted

- The company got working capital limits enhanced yet transactions routing was concentrated from single account hence continuation of overutilization
- No adequate justification for cheque bounces
- Onus of non-compliance was transferred to the Auditor and the same was changed for FY25

Suggestions

- If basic hygiene issues persists, weightage of growth is subsided
- After such reporting, change of auditor is a red flag

Risk of capital withdrawal

Details of the Company

- Not an entity specific but more it is constitution specific
- High number of instances observed in Proprietorship and Partnership constitution
- Higher proportion of director remuneration

Issues faced

- As promoters' skin in the game, partners/proprietor show infusion of unsecured loans by them/their relatives
- In the subsequent year, money is taken out either in the form of repayment of unsecured loans of withdrawal of capital
- Frequent withdrawal weakens capital structure

Option Resorted

- Marking such unsecured loans with quantification as subordinated to the bank facilities will enhance credibility

Suggestions

- Guide clients on importance of having such a convenient and its strict adherence
- Justified and reasonable partners' remuneration and interest of capital/USL can be a way out

Asymmetry of Data Submission

Details of the Company	• Leading player in forged components used in auto, defence, agriculture, power generation etc
Issues faced	• There were multiple submission of top customer data which was different every time • Sales data and customer wise sales data was not matching with Alternate Data Source (such as GST data, Volza data etc.)
Option Resorted	• The company was sensitized about the same. In response, they admitted the discrepancy and submitted another details stating the final one
Suggestions	• GIGO - Maintenance of accounts with accuracy will help in fetching correct data with consistency all the time. It is important as such asymmetry of data creates trust issues and looses its importance • It has rating impact and despite representation, the rating was not changed

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Lack of Management Depth/ Succession

Details of the Company	• Very frequently seen issue • Founder promoters are running the business and there is no succession planning • No second line of control formally placed
Issues faced	• Completely promoter centric decision making • His/her unavailability puts business at a halt
Option Resorted	• A team of professionals • Decentralized decision making
Suggestions	• Sensitizing the clients about importance of having organized structure of management which truly reflects going concern (not just forming part of notes to accounts)

Low Rating due to Unstructured Books

Details of the Company	• A well known restaurant brand in Mumbai with multiple outlets • The company had healthy collateral to offer to the banks hence it was able to secure requisite funding
Issues faced	• Collateral offered was ~Rs. 45-50 crore and as per the latest financials, net worth was ~Rs. 0.50 crore • Sales and profitability were so less that DSCR was below unity • Its growth ratios, solvency ratios, cash flows were indicating poor performance • As a result, the rating assigned was Below Investment Grade
Option Resorted	• The company was communicated with these Key Rating Drivers along with Provisional Rating Communication • The company reiterated that there would be enough liquidity to fulfil the obligation and if at all needed, promoters will infuse money
Suggestions	• It is encouraged that if the business is able to generate sufficient liquidity and promoters have capability, it should reflect in the audited financials • Strong balance sheet, healthy P&L, good business model automatically, drive rating to the deserving level

Delay in submission of details

Details of the Company

- Steel Trader having a scale of > Rs. 1,500 crores
- Investment grade ratings since many years

Issues faced

- We are bound by regulatory timeline to undertake periodic review
- Client was not submitting adequate details to carry out surveillance activity
- A caution letter was shared to the client but there was no response

Option Resorted

- The rating was moved to Issuer Non- Cooperating (INC) category
- A communication was shared to the client. The client was suddenly concerned about its rate of interest and other bank covenant
- The client submitted details within 4-5 days of communication and take out from INC category

Suggestions

- Importance of timely completion of surveillance activity
- Sensitizing on impact of migration to INC in future

Policy on Default and Rating performance

Types of Rating Instruments and Default Norms

- Long-term (LT) Instruments: Original maturity of more than a year
  - Debentures, bonds, Long-term bank loan, CC etc.
- Short-term (ST) Instruments: Original maturity of up to one year
  - Commercial paper, certificate of deposit, working capital demand loan, short-term loans, packing credit etc.

Facilities	Maturity / Repayment Schedule	Definition of Default
Term Loan, Working Capital Term Loan, Working Capital Demand Loan (WCDL), Debentures / Bonds	Defined maturity / repayment schedule	A delay of 1 day even of 1 rupee (of principal or interest) from the scheduled repayment date
Certificate of Deposits (CD) / Fixed Deposits (FD)		
Commercial Paper		
Packing Credit (Pre-shipment Credit), Bill Purchase / Bill Discounting / Foreign Bill Discounting/ Negotiation (BP/BD/FBP/FBDN)	Revolving	Overdue / unpaid for more than 30 days
Cash Credit	Revolving	Continuously overdrawn for more than 30 days
Buyer's Credit, Overdraft	Revolving	Continuously overdrawn for more than 30 days
BGs	Revolving	Amount remaining unpaid for more than 30 days from the invocation of the facility
LCs	Revolving	Overdue for more than 30 days from the day of devolvement

Rating Performance

	Short Run CDRs – 1-Year Default Rate (for the period FY2021-2025)
(%)	**CARE**
AAA	0.0
AA	0.0
A	0.0
BBB	0.3
BB	2.2
B	2.4
C	6.4

Q & A

Thank you

About Us

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics capability and detailed research methods. CareEdge Ratings is one of the leading credit rating agencies in India. It has an impressive track record of rating companies for almost three decades and has played a pivotal role in developing the corporate debt market in India. CareEdge provides near real time research on all domestic and global economic developments. The wholly owned subsidiaries include CareEdge Advisory & Research arm focused on providing advisory and consultancy services and CareEdge Risk solutions a platform that provides risk management solutions

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